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ABSTRACT

This report traces the historical development of federal housing policy that has promoted a 40% decline in substandard housing and a 20% increase in homeownership over the past 50 years. It presents emerging national and rural housing policy concerns: the proper role of federal, state, and local governments in the mortgage credit and insurance industries and the secondary mortgage markets; the design of federal housing and tax policies that will best encourage homeownership and still aid the neediest households in the most cost-effective manner; the development of demand-side subsidy programs that will encourage an increased supply of rental housing and aid low-income households; and the targeting of households who have insufficient income to afford adequate housing. Other policy issues considered are the affordability of homeownership for young families and the impact of changes in the tax status of rental properties on the quantity, quality, and cost of rental units. The report discusses differing housing needs of rural areas and shows percentages of funding obligations of selected housing programs going to nonmetropolitan areas. An appendix lists federal housing inadequacy criteria. (NEC)

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National and Rural Housing Policy

Historical Development and Emerging Issues

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ABSTRACT

The Nation's housing finance system has undergone dramatic changes in the past 50 years. This report traces the historical development of Federal housing policy and presents emerging housing policy concerns. The proper Government role in the areas of mortgage credit and insurance in the primary and secondary mortgage markets, homeownership policies, rental subsidy programs, housing affordability, and rural housing are discussed.

Keywords: Housing finance, housing affordability, homeownership, rural development.

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National and Rural Housing Policy

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INTRODUCTION

The Federal Government for over 50 years has sought to improve the quality of housing and to promote homeownership through innovations in housing finance and with direct and indirect subsidies for owner-occupied and rental housing. Dramatic progress has been made on each front, with a 40-percentage point decline in substandard housing and a 20-percentage point increase in homeownership [8].[1]

Housing expenditures as a proportion of household income have risen dramatically since the midseventies. In an era of pressure for Federal budgetary restraint, growing difficulties in affording housing along with the favorable trends of improving housing quality and increasing homeownership yield a substantially different mix of concerns for housing policymakers today than those faced a decade or two ago.

Public policy decisions on several key issues will have important effects on the future housing choices available to all Americans. These policy issues can be summarized in four questions:

(1) What is the proper role of Federal, State, and local governments in the mortgage credit and insurance industries and the secondary mortgage markets?

(2) How can Federal housing and tax policies best encourage homeownership and still aid the neediest households in the most cost-effective manner?

(3) How can Federal housing and tax policies best encourage an increased supply of rental housing and most efficiently aid low-income households through demand-side subsidy programs?

(4) How can Federal housing policy best target households who have insufficient income to afford adequate housing?

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[1] Underscored numbers in brackets refer to items in the References section. Less than 7 percent of the housing stock is considered substandard (that is, crowded and lacking complete plumbing); 65 percent of households own their own home.

Since rural America has become much more like urban America in the last 50 years, it is hardly surprising that the housing problems of rural America are much the same as those facing urban America. Nevertheless, there are differences between rural and urban areas in the comparative importance of these problems. For example, more houses in rural areas are occupied by their owners, so ownership policies are comparatively more important to rural residents. This report provides the historical background and current choices facing housing policymakers for each of these critical policy areas, and concludes with an exploration of the special problems facing rural America.

THE HOUSING FINANCE SYSTEM

Only 44 percent of American families owned their homes in 1930. The typical home mortgage ran for less than 10 years, required a 40- to 50-percent downpayment, and provided for repayment of 6 to 8 percent interest over the life of the mortgage, with a single "balloon payment" of the original principal at expiration [3]. However, the massive defaults on owner-occupied housing brought on by the Great Depression precipitated major Government-sponsored institutional changes designed to avert the imminent collapse of the housing finance system and shield it from similar occurrences. The changes created a new regulatory environment with incentives for lenders making home loans, and a new mortgage instrument that was consistent with family budgets. The Federal Home Loan Bank Board (FHLBB) and 12 regional banks were established to regulate and provide reserves to the Nation's savings and loan (S&L) and thrift institutions. The S&L's joining the system were required to invest most of their assets in home mortgages and the earnings on these qualifying assets were exempt from taxes. Newly created Federal deposit insurance helped to restore confidence in thrifts and assure them a steady source of loanable funds. The Federal Reserve System's Regulation Q, which capped interest rates that commercial banks could offer for deposits at a lower rate than S&L's could offer, gave a competitive edge to the specialized thrifts.

Creation of the Federal Housing Administration (FHA) in 1934 ushered in a revolution in the system of housing finance. By charging borrowers a small premium and insuring the full mortgage amount, thereby protecting lenders from default losses, the FHA encouraged acceptance of long-term, low-down-payment, self-amortizing (all interest and principal repaid over the life of the loan), level-payment mortgages. This new mortgage featured substantially lower downpayments and monthly payments, bringing homeownership within the reach of many more families. The FHA also insured mortgages on low-cost multifamily rental housing, and later introduced subsidized homeownership and rental programs.

Congress sought by creating FHA to encourage the development of a private secondary market where FHA-insured mortgages could be purchased from lenders and resold to investors. Congress hoped that a secondary market for mortgages would free lenders from their role as ultimate investors in a location-specific mortgage loan by opening a channel between housing investment and private capital markets. After no private mortgage

associations had been formed, Congress chartered the Federal National Mortgage Association (FNMA) in 1938, which was authorized to buy and hold mortgages as investments.

The FNMA system functioned well until the midfifties. With a relatively stable interest rate structure and tax exemption, thrifts found it profitable to specialize in mortgage lending. Discretionary lenders, such as life insurance companies and commercial banks, supplied the residual mortgage credit and, thus, had a significant role in the system.

Two additional Government mortgage loan programs were initiated after World War II. The Veterans' Administration (VA) shouldered the lender's default risk by guaranteeing up to 60 percent of the mortgage loan amounts originated by private lenders for qualified borrowers, and the Farmers Home Administration (FmHA) was authorized to provide direct loans to farm families unable to obtain private credit for housing. The activities of FmHA were expanded in the sixties to extend coverage to nonfarm families in rural towns with a population of less than 20,000 and to make below-market interest loans for single and multifamily housing.

FHA was dominant in the mortgage market during the early postwar period. But, by the midfifties, its quantitative importance had diminished as an expanding housing sector within a growing economy made uninsured and privately insured mortgages attractive investments for private institutions. FHA insured mortgages on only about 16 percent of all single-family housing units by the end of 1956, down from over 23 percent (on average) in the late thirties. This pattern of decline continued through the seventies, except for 1970 and 1971 when major activity in FHA's new interest subsidy programs (Sections 235 and 236) temporarily raised FHA's share of all U.S. housing starts to a high of 29 percent [10].[2]

FHA activity declined through the seventies for several reasons. Increasing interest rates and house prices made the fixed mortgage limits and rates of FHA's mainstream programs less relevant to home buyers. The front-end fees or points used to adjust the administered FHA mortgage rate to the market rate sometimes made FHA borrowing more expensive than conventional borrowing. Increasing red tape generated by a growing body of environmental and fair housing laws increased the time and effort associated with FHA mortgages, making them less attractive [9]. Most important was the fact that private mortgage insurers, learning from FHA's experience, began to emerge and provide services to the most profitable portion of FHA's market--upper income households. FHA was forced to concentrate its activities in the high-risk segments of the housing market, reducing its ability to provide insurance under the existing premium system without subsidies [13].

FNMA, intended as a vehicle to increase the confidence of mortgage lenders by insuring the liquidity and marketability of their investments, was made a partially private corporation in 1968. Its mortgage subsidy functions

---

[2] FHA was transferred to the newly created U.S. Department of Housing and Urban Development (HUD) in 1965.

were separated and lodged in a new Government corporation, the Government National Mortgage Association (GNMA). The Government retained some control over FNMA in that a third of its board of directors was appointed by the President, and the Department of Housing and Urban Development (HUD) was given regulatory oversight authority. FNMA was allowed a $3.5-billion line of credit with the Treasury and its securities were given Federal agency status (exempting them from a variety of reporting requirements). The volume of purchases by FNMA grew rapidly after 1970, reaching $71 billion in mortgages by 1980 [3, 10]. FNMA remains a major market for FHA mortgages originated primarily by mortgage bankers, but well over a third of its total purchases are conventional mortgages [10].

GNMA introduced a securities program in 1970 aimed at expanding the sources of mortgage credit. This GNMA program guaranteed timely payment on securities that were collateralized by pools of FHA-insured mortgages. Purchasers of these securities bought an undivided share of the mortgage pool and received a return that reflected the payment of principal and interest on the pooled mortgages. Because these payments are passed through to ultimate investors, the arrangement is known as a pass-through security. The pass-through security helped GNMA link mortgage originators with capital market investors, which, in turn, helped integrate mortgage markets with bond markets. Brokers originate a group of mortgages at a given interest rate, obtain a guarantee commitment from GNMA, and sell securities backed by the mortgage pool to investors. The rate of return on the securities is tied to the mortgage rate and is approximately 0.5 percentage point lower to account for servicing fees and to pay for the GNMA loan guarantee [10].

The Federal Home Loan Mortgage Corporation (FHLMC) began issuing similar securities, called participation certificates, following the success of the GNMA pass-through security. These securities were backed by pools of conventional mortgages that had been purchased by the FHLMC. FmHA also markets pass-through securities called certificates of beneficial ownership, which are backed by the mortgages it originates. These certificates are sold exclusively to the Federal Financing Bank to replenish FmHA's revolving fund, thereby channeling funds raised by the Treasury into rural housing markets [10].

The development of mortgage-backed securities by GNMA and FHLMC and the more recent successful marketing of similar securities by FNMA have served two functions for the housing finance system. First, ownership of mortgages can now be readily transferred since mortgages are represented by instruments with characteristics comparable to other securities regularly traded in financial markets. Second, although the total volume of GNMA securities may be limited due to the limited issues of FHA and VA mortgages, the GNMA experience has provided the model for the potentially much larger conventional mortgage market that might be served by private issuers [10].

Volatile interest rates during the seventies and the rapid decline in inflation rates in the early eighties have caused substantial difficulties for many institutions involved in home mortgages. A critical policy issue in housing finance that will continue to command attention for years to come revolves around mortgage credit industry adjustments to financial

problems within a deregulated environment. Interest rates rose during the seventies in part beause deposit rates were deregulated. The thrift industry found itself facing high interest costs on its deposits while collecting income on low-interest, long-term, fixed-rate mortgage assets placed prior to deregulation. As a result, the thrift industry had a substantial negative net worth. The drop in interest rates over the last several years has helped the thrift industry recover; but many thrift institutions continue to operate with a negative net worth, and continue to lose money. Liquidating or recapitalizing these insolvent thrifts poses a significant challenge to the Federal deposit insurance system.

The profit squeeze faced by thrift institutions at the beginning of the decade has left even solvent institutions seriously undercapitalized. Owners of thrifts, having little equity to lose if their investments do not pay off, have an incentive to pursue risky investments which, if successful, have a large payoff. To reduce excessive risk taking, bank regulators placed restrictions on the types of activities that thrifts could pursue and, in theory, imposed minimum capital requirements. Nonetheless, potential large payoffs will remain as long as the market value of a thrift's equity is low. Incentives to discourage high-risk investments by thrifts need to be developed to improve the longrun prospects for the Federal deposit insurance system. The extent to which these incentives will reshape the way home mortgages are financed is a key concern.

Another critical issue in housing finance is to determine the proper role for existing Federal agencies operating in the mortgage insurance industry and the secondary mortgage markets. Problems experienced by the thrift industry, and the extent to which the taxpayer implicitly or explicitly shares the ultimate cost of resolving these problems, have raised questions about the wisdom of governmental support for, and involvement in, the mortgage credit industry [1]. Advocates of a more limited Federal role point out that commercial banks and private firms currently are major participants in the secondary market for mortgages and, thus, mortgage lending does not require a special subsidized thrift industry. The Reagan Administration has made no attempt to dismantle the present mortgage finance system, but it has sought to increase program efficiency while removing any competitive edge enjoyed by FHA mortgage insurance programs. The Administration has also attempted to remove Federal and State regulatory barriers to the emergence of private issuers of mortgage-backed securities that can be traded in secondary mortgage markets. The extent to which the mortgage finance system will be "privatized," and the effect of such a change on housing finance, deserve close attention by policymakers.

A third issue is whether to allow continuation of tax-exempt mortgage revenue bonds issued by State and local governments. These bonds finance single and multifamily housing for certain targeted groups. While these bonds permit Federal subsidy (through the lower rate paid on tax-exempt bonds) of additional housing without the overhead of a Federal agency, part of the subsidy accrues to tax-exempt bond investors, making the revenue loss to the Federal Government 30-50 percent higher than the benefits received by the borrower. The same housing objectives might be achieved at lower cost to the Federal Treasury with a program of tax credits or direct subsidies. In addition, issuance of mortgage revenue bonds may place upward pressure on all tax-exempt interest rates, thereby raising the

general borrowing costs for municipalities. Reliance on the tax-exempt market to finance single and multifamily housing has grown rapidly in the last few years, from about $1 billion in 1975 to $17 billion in 1983 [9]. Tax legislation, IRS regulations, and policy decisions to limit or expand reliance on the tax-exempt bond market will alter the benefits and costs of this subsidization device in the years ahead.

HOMEOWNERSHIP

Encouragement of homeownership has traditionally been a major objective of Government housing policy. This goal has been fostered by the housing finance system, the mortgage interest and property tax deductions for Federal and State income taxes, and continued economic growth. Special subsidized homeownership programs (such as FmHA's Section 502 interest credit program and FHA's Section 235 program) have advanced homeownership to low-income households who would have found owning a home nearly impossible otherwise. About two-thirds of all American households owned their own home in 1984, compared with fewer than half in 1940 (fig. 1).

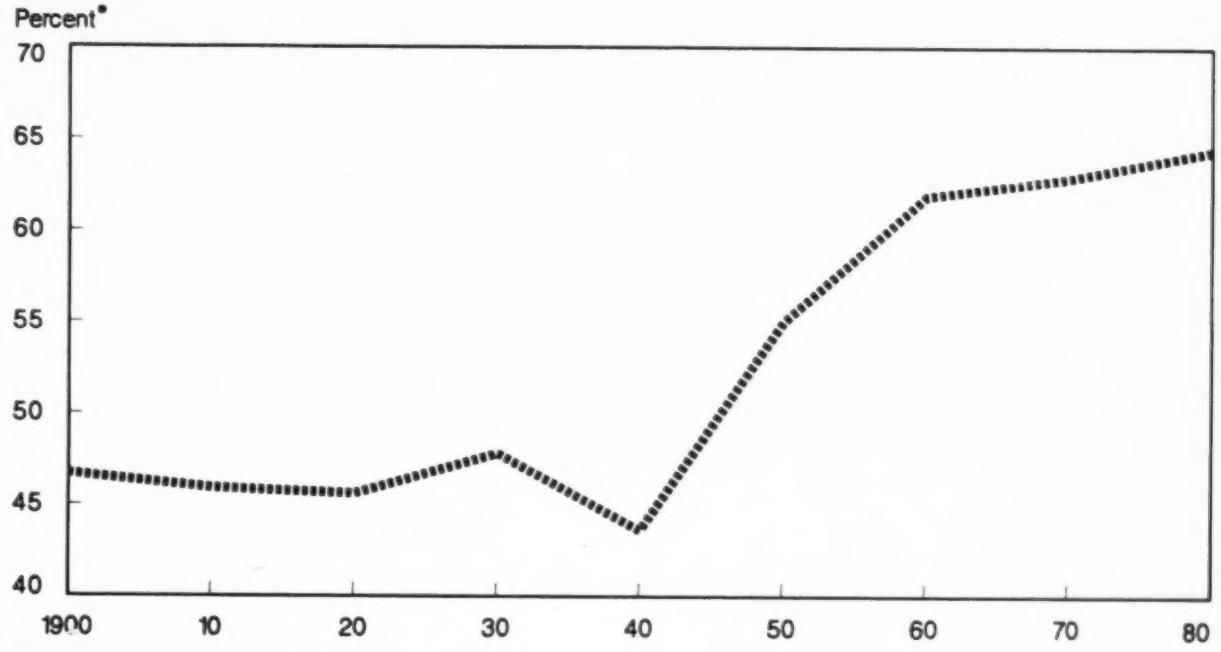
The quality of new owner-occupied homes has risen markedly as well. New single-family homes averaged 1,700 square feet in 1978—an increase of 20 percent since 1964. The percentage of new conventional homes with two or more baths increased from 46 percent in 1963 to 73 percent in 1980, and the percentage of homes with air conditioning more than doubled [2]. Only 4.3 percent of owner-occupied homes in 1983 were considered inadequate and only 2.3 percent had what might be termed a major defect according to the Congressional Budget Office (see appendix) [11].

Increased affordability is a primary reason for the improved quality of owner-occupied housing and the shift to homeownership (fig. 2). The cash cost of homeownership (including mortgage payments, property taxes, and insurance, utility, and maintenance costs) rose steadily relative to income between 1965 and 1979, while total cost (accounting for deductibility of mortgage interest and property taxes and for expected capital gains) fell dramatically. Mortgage interest rates rose less than 2 percentage points between 1975 and 1979 while the annual inflation rate of 7.5 percent increased marginal income tax rates and thus the proportion of mortgage interest that most households could deduct from Federal and State income taxes. House values increased at an annual rate of 12.5 percent over the same period, fueling the expectation of substantial capital gains from housing investment. The lower total costs of homeownership encouraged homeowners to buy larger and better homes and led many higher income renters to become homeowners [2]. The condominium market grew to accommodate the increased demand for homeownership amid the waning demand for rental housing.

Mortgage interest rates rose to 16 percent by 1981, and the cash costs of owning the average new home rose to nearly 60 percent of median family income. The total cost of homeownership increased sharply from zero to 27 percent of median income as housing price appreciation slowed and expected capital gains were revised downward. Cost conditions have improved since 1981 with reductions in mortgage interest rates and inflation, but the direct cost of owning as a ratio of median income in 1983 was nonetheless

Figure 1

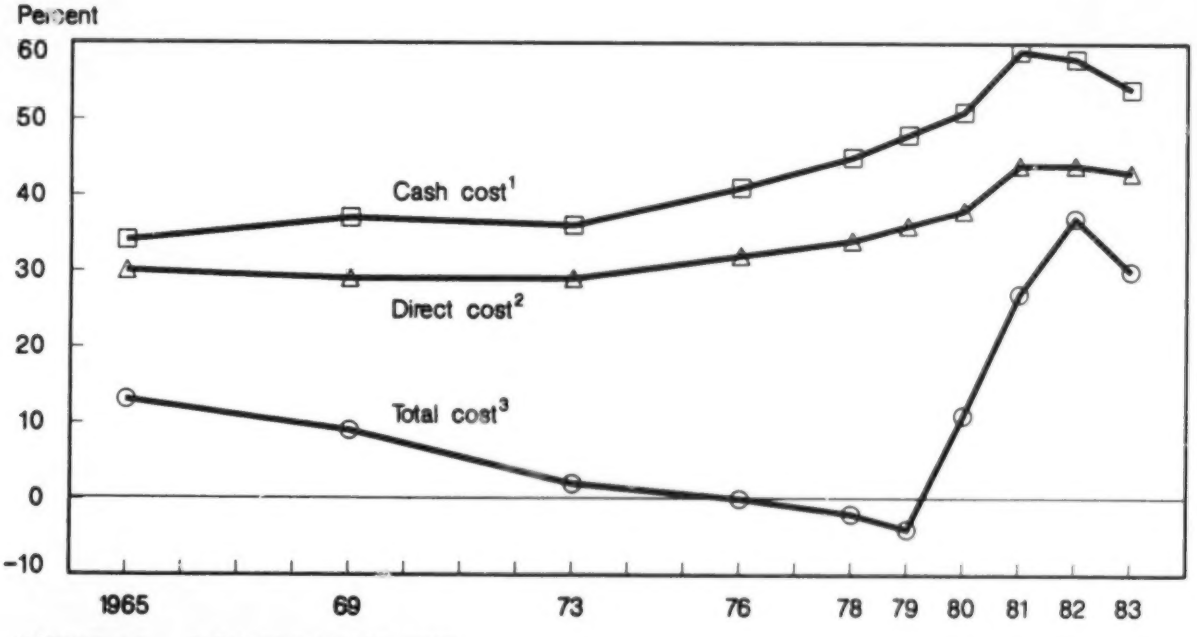
Homeownership in the United States



* Percentage of households who own their own home.
Source: Compiled from data in U.S. Department of Commerce, Bureau of the Census, Decennial Census of the United States. Washington, DC: U.S. Government Printing Office as reported in (8).

Figure 2

Homeownership costs as percentage of median income



1/ Total cash costs. 2/ Total cash cost net of tax savings.
3/ Total cash cost net of tax saving and expected capital gain including forgone interest on equity.
Source: Appendix table IV of (2).

high (44 percent) by historical standards. Thus, it has remained difficult for many households, especially first-time homebuyers, to acquire homes [2].

A critical issue facing policymakers is making homeownership affordable for young families. These families usually earn less than the median income and lack the assets necessary for a downpayment. Discussions of this issue will likely include the merits of lower interest rates, alternative mortgage instruments, tax subsidies for building a downpayment, and lower cost housing alternatives, such as smaller or manufactured housing. Devising appropriate programs with minimal Federal involvement will likely command attention when mortgage interest rates begin rising again.

Another policy issue concerns the deductibility of mortgage interest and property tax payments from taxable income, which constitutes a subsidy to homeowners because the imputed rental income of their dwellings goes untaxed. The Urban Institute reported that about $30 billion in Federal income taxes went uncollected in fiscal 1981 because of the mortgage interest and property tax deductions [10].[3] The tax subsidy is larger for higher income families because their marginal tax rates are higher. At a time when Federal budget deficits have policymakers scrambling to close tax loopholes and find new revenue sources, the propriety of this subsidization device has been questioned. The deductibility of mortgage interest has nearly universal appeal among homeowners and will likely survive in some form, but limits may be placed on the size of the deduction. Then too, changes in the marginal rate structure will change the "value" of the deduction for many homeowners. How these changes affect the cost of housing among various socioeconomic groups should be a principal concern to policymakers.

A third concern for policymakers relates to the design and targeting of homeownership programs such as the FmHA Section 502 program and the FHA Section 235 program. The current deficit situation places increased pressure to limit eligibility in such programs to a smaller group of households who are most in need. While FmHA's Section 502 program is restricted to low-income households, the FHA's Section 235 program currently includes some moderate-income households. In addition, given that these programs are primarily new construction programs, which are quite costly, alternative cost-effective program designs will likely be considered for delivering housing services to lower income groups. A key concern will likely revolve around making these types of programs less costly for the Federal Government while aiding the lowest income families in need of housing assistance.

A fundamental policy issue inherent in many of the deficit reduction proposals being considered has to do with the Federal Government's policies encouraging homeownership. Proposals aimed at privatizing major portions of the mortgage finance system, restricting eligibility for Federal

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[3] Renters indirectly receive a similar subsidy since mortgage interest and property taxes are deductible as business expenses from landlord rental income. In addition, rental property may be depreciated, yielding further tax savings.

homeownership programs, and limiting the tax advantages of homeownership all suggest that policymakers are revising their view of the Federal Government's role in promoting homeownership. Concerns are likely to focus on the social, political, and economic benefits of homeownership, and the budgetary costs of Federal policies promoting ownership, with an eye toward targeting subsidies to homebuyers.

RENTAL HOUSING

Rental housing quality has improved dramatically so that only 5.9 percent of the rental stock had a major housing defect in 1983 [11]. Falling real rents, however, have reduced the overall profitability of rental housing since 1970. A comparison of rental prices with other prices shows that rental levels for a home or apartment of constant quality have declined by 8.4 percent in the past 20 years when adjusted for inflation. In many areas, lagging rents and rising interest rates and operating costs have made refinancing of rental properties difficult while making existing rental housing unprofitable, according to the President's Commission on Housing [8]. The rental market has remained viable primarily because of the tax advantages and expected future capital gains associated with rental property rather than the property's rental income-earning capacity.

This trend is not surprising considering the developments regarding homeownership. The dramatic decline in the effective cost of homeownership—a substitute for rental housing—could only reduce the demand for, and earnings of, rental housing as higher income renters were attracted to homeownership.

Despite the fall in real rents, rent-to-income ratios have gone up. The exodus of higher income renters to homeownership left the pool of renters more highly concentrated within the lower income range and produced a higher aggregate rent-to-income ratio. As a result, the perception grew that rents were becoming exorbitant. This perception has led to concern about the ability of renters to afford adequate housing and has fueled efforts to institute various forms of rent control in many communities and attempts to subsidize housing.

Rent control has been recently instituted in a number of communities, perhaps the most publicized being Santa Monica, CA. The long-term negative consequences of rent control are well known to analysts. New York City stands as a monument to those consequences—after 40 years of rent control, the city has a disproportionately high percentage of deficient housing with little rental housing being built or rehabilitated without subsidization.

Major changes in low-income rental housing programs were taking shape in the late sixties. Efforts began to shift funding from costly and cumbersome construction-oriented programs to demand-oriented rent certificate programs. HUD's Section 8 existing rent certificate program had well over a million families enrolled by 1983 and rivaled HUD's much older Public Housing Assistance program. Virtually all of HUD-sponsored new construction programs have been halted, and an experimental demand-side rental voucher demonstration program is being implemented.

A critical issue related to rental housing concerns the tax treatment of rental properties. Proposed changes in depreciation provisions, capital gains on land and structures, allowed interest expense for limited partners, and the level of the historic rehabilition tax credit will affect the real after-tax rates of return on rental housing. The extent these changes will affect the quantity, quality, and cost of rental units, both currently and over time, needs to be researched.

Another critical issue involves the operation of current demand-side low-income rental subsidy programs. Policy analysts continue to examine evidence from the Experimental Housing Assistance Program conducted through the seventies in an attempt to determine the supply and demand responses of alternative refinements of demand-side subsidy programs. A demonstration sponsored by HUD is currently under way in numerous cities and will provide additional data on the implications of various housing voucher programs under consideration.

AFFORDABILITY OF ADEQUATE HOUSING

Housing cost has replaced housing quality as a primary public concern. In line with the new emphasis on housing affordability, many policymakers focus on rising rent-to-income ratios and rising average house prices relative to median income. A new ERS study [4] takes the more meaningful approach of comparing household incomes with estimated rents for housing that is just adequate—housing that just meets the Section 8 existing housing program standards. This method allows us to discriminate between families that have too little income to reasonably afford adequate housing and those with sufficient income who can choose substantially more than adequate housing.

According to the ERS study, 17.3 percent of all U.S. households had insufficient income in 1975 to rent adequate housing for less than 30 percent of their income. Of renters, 28.6 percent required more than 30 percent of their income on adequate housing in 1975. More recent findings show that 22.2 percent of all U.S. households and 36.3 percent of renters had insufficient income to rent adequate housing for less than 30 percent of their income in 1983. Another 16 percent of renters in 1983 (12 percent in 1975) spent over 30 percent of their income to rent better than adequate housing [4].

A critical issue for future housing policy is how to target programs to the growing pool of households whose incomes are insufficient to rent or purchase merely adequate housing without subsidizing additional housing for families already able to afford adequate housing. The effect of current proposals and policy issues on affordability has been raised within the context of housing finance, homeownership, and rental housing issues. However, special attention needs to be directed toward the impact of these proposals on the numbers of people who will be unable to afford minimally adequate housing.

RURAL HOUSING

Rural housing needs differ from those in urban areas in many respects. Rural areas have a higher proportion of homeowners, single-family detached units, mobile homes, and units lacking complete plumbing, and a lower proportion of multifamily units (table 1). Rural households also have lower average income and are more often elderly. Mortgage credit has historically been less readily available at reasonable rates in rural areas than in urban areas [5].

Federal housing programs have been developed to address the special needs of rural areas. The housing credit programs of FmHA serve rural areas, nonmetro places of 20,000 people or fewer, and metro places of 10,000 people or fewer. HUD and the VA also provide considerable housing assistance to rural areas.

The two major FmHA housing programs are Section 502 program for homeowners and Section 515 program for rental housing. The 502 program subsidizes mortgage interest to low- and moderate-income rural homeowners. The Section 515 program provides low-interest and subsidized low-interest-rate loans for building or rehabilitating rental housing for low- and moderate-income residents in rural areas. In 1985, over 75 percent of Section 502 and Section 515 assistance went to nonmetro areas (table 2 assumes that the percentage distribution of 1985 funds to nonmetro areas was the same as in 1980).

Table 1—Characteristics of nonmetro and metro year-round housing units, 1983

Housing characteristic	Nonmetro	Metro
	Percent	
Owner-occupied	73	61
Single-family detached	76	56
Multifamily	14	36
Mobile home	8	3
Lacking complete plumbing	5	1

Source: 1983 Annual Housing Survey, U.S. Department of Commerce (11).

HUD distributes approximately 17 percent of its housing program funds to nonmetro areas (1985 figures, assuming nonmetro shares of programs remained equal to 1980 levels). The largest HUD single-family program is Section 203(b) Home Mortgage Insurance program, which insures mortgages up to $67,500 (higher in high-cost housing markets). Loan payments rise gradually according to a preset schedule under the Section 245 Graduated Payment Mortgage Insurance program. Other HUD single-family programs are the Section 235 Low-Income Family Loans program (which subsidizes interest costs to low-income households and has a $40,000 mortgage limit) and the Property Improvement and Mobile Home Loan Insurance (Title 1) program. The shares of these single-family programs going to nonmetro areas ranged from 9 to 23 percent (table 2).

HUD also assists in financing multifamily units, with the requirement that some of the occupants be low-income households. The Section 221 Low-to-Moderate Income Housing Market Rate programs insure loans for the construction, rehabilitation, or purchase of low- and moderate-income multifamily housing. HUD makes long-term, direct loans at below-market interest rates to cooperatives and nonprofit corporations to finance rental or cooperative housing for elderly or handicapped persons through its Section 202 program. The Federal Government subsidizes both the development and operating costs of multifamily structures under Public Housing Assistance. Section 8 Low-Income Assistance programs provide rent subsidies to low-income households in existing units. Considered individually, from 18 to 26 percent of 1980 funding for these programs went to nonmetro areas (table 2).

VA provides mortgage insurance to members and veterans of the armed forces through its guaranteed loan program. This program devoted 14 percent of its 1980 funding to nonmetro areas (table 2). In addition, the VA operates a direct loan program in rural areas and small cities and towns designated as credit-short areas.

Households that obtained FmHA loans from 1977 and 1979 differed significantly from other mortgage borrowers. FmHA borrowers tended to be younger and have much lower incomes than other borrowers. A greater proportion of FmHA mortgage recipients were single females, received income from Social Security, and had no more than a high school education. FmHA participants purchased smaller and lower-valued homes than other borrowers (table 3).

A greater proportion of FmHA participants were first-time homebuyers than were other borrowers. These first-time homebuyers tended to have low incomes and, thus, less capability of making a significant downpayment. In 1979, 50 percent of low-income FmHA borrowers made no downpayment--a rare occurrence for conventional and FHA borrowers [11].

FmHA housing programs are small compared with FHA and VA; but FmHA programs fill two important needs not fully met by other programs. First, FmHA programs serve rural areas. Roughly 75 percent of FmHA loans go to nonmetro areas, compared with less than 13 percent of FHA and VA programs. (But FHA and VA programs are so much larger that their dollar volume of

Table 2--Total funding obligations of selected housing programs

Program	United States, 1985	Nonmetro areas	
		1980	1985 estimates
	Million dollars	Percent	Million dollars
FmHA:			
502 Low- to Moderate-Income Housing Loans	1,809	76	1,377
515 Rural Rental Housing Loans	903	78	703
HUD:			
Single-family--			
203(b) Home Mortgage Insurance	15,745	14	2,157
245 Graduate Payment Mortgage Insurance	1,072	9	100
235 Low-Income Family Loans	7	18	1
Property Improvement and Mobile Home Loan Insurance [Title I]	1,299	23	296
Multifamily--			
221 Low- to Moderate-Income Housing Market Rate 1/	973	18	173
202 Housing for the Elderly and Handicapped	597	24	143
Public Housing Assistance 2/	3/ 3,344	26	3/ 863
Section 8 Low-Income Housing Assistance 2/	3/ 6,848	21	3/ 1,438
Veterans guaranteed and insured loans	12,140	14	1,639

1/ The single-family component 221(d)(2) constitutes less than 15 percent of the current 221 programs.
2/ Noncredit, low-income, rental assistance programs.
3/ Budget authority.
Source: Fiscal 1985 budget data were taken from [6] and [12]. The 1980 data for nonmetro percentages were obtained from [7] and were used to estimate nonmetro dollar figures for 1985.

Table 3—Characteristics of recent housebuyers, by types of mortgage obtained, 1977-79

Item	FmHA	FHA	VA	Conventional
Households with:			Percent	
Less than $15,000 income	59.5	33.6	19.7	30.1
Less than $10,000 income	28.7	13.1	1.5	12.8
Income from Social Security	12.1	3.5	7.1	8.2
12 years or less schooling for head	69.2	59.6	40.2	56.0
Head over 64 years of age	1.2	1.0	.3	2.7
Head under 35 years of age	73.6	64.7	51.5	54.8
Single female head under 45 years of age	13.5	6.4	.9	4.0
Black head	7.4	6.1	4.9	2.6
			Median	
Household income (dollars)	12,422	18,375	22,356	20,443
Age of head (years)	30.6	32.1	34.7	33.9
Currently occupied housing unit:			Percent	
Valued under $40,000	67.9	42.2	20.6	25.3
Five or fewer rooms	68.7	50.4	31.1	44.7
Three or fewer bedrooms	94.0	84.8	79.5	82.2
No more than one bathroom	65.6	42.7	32.6	38.5
			Median	
House value (dollars)	36,262	44,186	54,018	56,798
Previously occupied housing unit:			Percent	
Owned	30.1	46.5	45.4	65.3
With complete plumbing	95.4	100.0	98.2	98.4
Single-unit structure	78.6	73.8	68.4	82.5
Rented under $125/month	42.2	13.8	15.8	31.4
Valued under $20,000	56.0	24.6	16.8	17.2

Source: 1979 Annual Housing Survey, U.S. Department of Commerce (11).

loans in nonmetro areas is higher than for FmHA.) Second, FmHA serves a different, lower-income population. Most FmHA borrowers would not qualify for other credit assistance.

Recent proposals to transfer FmHA housing obligations to FHA or VA would require a major effort by these agencies. Legislative changes in the credit programs of HUD and VA would be needed to provide subsidies to serve the lower income clientele FmHA now serves.

A critical issue for rural housing policy concerns rural credit needs in the current deregulatory environment. The deregulation of financial markets has made the housing credit market more and more a national market, with credit now often available at similar terms in rural and urban areas. This raises the issue of whether special Federal credit assistance in rural areas is needed and whether a separate agency, FmHA, is needed to provide credit to rural areas.

The proper division of funding between owner-occupied and rental housing in rural areas is another concern. Homeownership continues to be more prevalent in rural areas than in urban areas, but demographic trends indicate an increasing need for rental units in rural areas. In response, FmHA's rental program has expanded in recent years. Policymakers must continually assess the proper allocation of program funding for rental and owner-occupied housing and also for special categories of assistance such as mobile homes.

A third critical issue concerns the form of housing subsidy. Funding of construction-oriented programs (such as HUD's Public Housing) has historically been a significant part of housing assistance to rural areas. Many analysts claim that new construction subsidies are less effective and more costly than demand-side subsidies. Others argue that construction-oriented subsidies continue to have merit in rural areas, where development and construction costs are much less than in urban areas. Policymakers will, therefore, need to reevaluate the cost effectiveness of alternative forms of housing subsidies both in general and in rural areas.

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APPENDIX--Housing Inadequacy Criteria

A unit is classified as inadequate if it has at least one of the following conditions:

1. The absence of complete plumbing facilities for exclusive use.
2. The absence of complete kitchen facilities for exclusive use.
3. The absence of a public sewer connection, septic tank, or cesspool.
4. Three or more breakdowns of six or more hours each time in the sewer, septic tank, or cesspool during the prior 90 days.
5. Three or more breakdowns of six or more hours each time in the heating system during the past winter.
6. Three or more times completely without a flush toilet for six or more hours each time during the prior 90 days.
7. Three or more times completely without water for six or more hours each time during the prior 90 days.

or if the unit has two or more of the following conditions:

8. Leaking roof.
9. Holes in interior floors.
10. Open cracks or holes in interior walls or ceilings.
11. Broken plaster over greater than one square foot of interior walls or ceilings.
12. Unconcealed wiring.
13. The absence of any working light in public hallways for multi-unit structures.
14. Loose or no handrails in public hallways in multi-unit structures.
15. Loose, broken, or missing steps in public hallways in multi-unit structures.

Source: Congressional Budget Office, Federal Housing Policy: Current Programs and Recurring Issues (Washington, DC: U.S. Government Printing Office, 1978), pp. 4-6. CBO used the term "needing rehabilitation" in place of "inadequate."

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